

## Management's Discussion and Analysis

This analysis, prepared by the Office of the Comptroller, offers readers of the Commonwealth's financial statements a narrative overview of the activities of the Commonwealth for the fiscal year ended June 30, 2004 (FY04). We encourage readers to consider this information in conjunction with the additional information that is furnished in the letter of transmittal, which can be found preceding this narrative, and with the Commonwealth's financial statements, which follow. This analysis is required by the Governmental Accounting Standards Board (GASB) which provides preparers with guidelines on what must be included and excluded from this analysis. All amounts, unless otherwise indicated, are expressed in thousands of dollars.

### **Financial Highlights – Primary Commonwealth Government**

#### *Government – Wide Highlights*

♦ **Net Assets** – The liabilities of the Commonwealth exceeded its assets at the end of FY04 by nearly \$3.9 billion. Of this amount, “unrestricted net assets” is reported as a negative \$11.3 billion. The primary reason for negative unrestricted net assets is that the Commonwealth is incurring long-term obligations to either construct or assist political subdivisions in constructing assets owned by these political subdivisions. For example, upon completion the Central Artery / Third Harbor Tunnel will be owned by the Massachusetts Turnpike Authority and the Massachusetts Port Authority. The Commonwealth, however, is paying for the construction of these assets and significant debt is being incurred to pay those costs. Similarly, the Commonwealth has a liability of \$3.3 billion for its share of the construction costs of schools owned and operated by municipalities. In FY05, legislation will change the funding of school construction from a direct appropriation to a dedicated portion of the sales tax administered by an authority. There are also significant restricted net asset balances set aside for unemployment benefits and debt retirement.

♦ **Changes in Net Assets** – The Commonwealth's net assets increased by over \$1.8 billion in FY04. Net assets of governmental activities increased by the majority of this \$1.8 billion. This increase in net assets is primarily attributable to an increase in tax revenues by over \$1.2 billion above prior year collections. Net assets of the business – type activities showed an increase of over \$41 million. Expenses of governmental activities were over \$31.2 billion. General revenue for the Commonwealth, net of transfers, but including taxes, investment income and tobacco settlement income from governmental activities was over \$17.4 billion.

#### *Fund Highlights*

♦ **Governmental Funds – Fund Balances** – As of the close of FY04, the Commonwealth's governmental funds reported a combined ending fund balance of over \$4.4 billion. Of the \$4.4 billion:

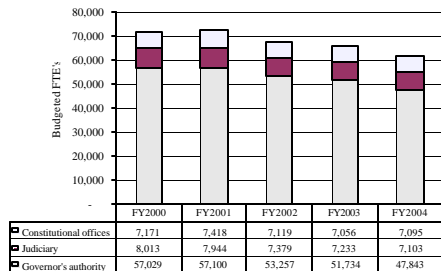
- Nearly \$994 million, represents unreserved fund balance. This is a turnaround from previous years. However, nearly a \$701 million deficit in the highway fund remains due to the timing of accruals. The unreserved general fund balance of over \$1.0 billion offsets the highway fund deficit. Pursuant to new accounting standards, \$126 million has been declared as a receivable in the governmental funds related to anticipated tobacco settlement proceeds in FY05.
- For FY04, the Legislature adopted a more straightforward definition of fiscal balance to include all of the budgeted activity. The result was the elimination of a number of funds, including the local aid fund. The previous definition of fiscal balance only included the fund balance within three major funds. As a result of these changes, several minor Governmental Funds have also been closed.
- Governmental reserves total over \$3.4 billion. They include nearly \$639 million for continuing appropriations, over \$1.1 billion for stabilization, nearly \$735 million in bond proceeds reserved for capital projects, largely connected with the Central Artery / Tunnel (CA/T) project and over \$761 million reserved for retirement of indebtedness. Over \$159 million is reserved for the CA/T owner controlled insurance program for workers' compensation and general liability. This reserve is net of nearly \$83 million of projected long-term claims payable that are only reflected on the statement of net assets.

To meet the fiscal challenges of fiscal 2004 and beyond, the Commonwealth took a series of measures to remain in fiscal balance.

- \$531 million was transferred from the Stabilization Fund to pay for current expenditures. However, at the close of the fiscal year, \$357 million was redeposited into the fund from tax revenues held aside during FY04. An additional \$663.5 million was transferred to the fund from surplus. Beginning in FY06, an additional 0.5% of current year net tax revenues must be deposited into the Stabilization Fund before the year – end surplus is determined in addition to the current statutorily required carry-forward amount. Finally, the ceiling on the balance in the Stabilization Fund was increased from 10% to 15% of total current year budgeted revenues.
- All of the tobacco settlement proceeds for the year were used in support of current operations.
- The Commonwealth refunded over \$2.8 billion in General Obligation Bonds and Grant Anticipation Notes, continuing to take advantage of some of the lowest interest rates in history. An additional \$408 million was raised in a crossover refunding of the Grant Anticipation Notes (GANs). This technique results in a legal defeasance of debt, but not an accounting defeasance until the refunded principal is paid in the future.

- To fund a deficit in the Unemployment Compensation Fund due to higher payments to recipients than receipts, the Commonwealth received interest-free loans from the federal government between January and April 2004, incurring a net total liability of \$417.9 million. All of these borrowings were paid back in May 2004. The balance of the fund stands at \$468.7 million, or about 19% of FY04 benefits paid.

**Budgeted Full Time Equivalent Workforce  
Including Budgeted Higher Education  
June 2000 – June 2004**



The Commonwealth also took measures operationally to achieve balance.

- The budgeted full time equivalent workforce including higher education, dropped from 66,023 as of June 2003 to 62,041 as of June 2004. The graphic to the left details the reductions over the last five years.
- Starting in FY04, the employee's share of group health insurance premiums increased from 15% to 20% of the cost of the insurance for those who earn more than \$35,000. All new employees hired after June 30, 2003 contribute 25% of the cost of the insurance, regardless of salary.
- Tax decreases put in place earlier than FY02 remain frozen. The income tax rate remains at 5.3%. The graduated capital gains tax portion has also been frozen at 5.3%.

## OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis is intended to serve as an introduction to the Commonwealth's basic financial statements. The Commonwealth's basic financial statements are composed of three components: 1) government-wide financial statements, 2) fund financial statements, and 3) notes to the financial statements. This report also contains additional required supplementary information in the form of budgetary schedules, which are prepared on the statutory basis of accounting, as well as other supplementary information.

### Government – wide Financial Statements and how they relate to other perspectives

The government - wide financial statements present the reader with a broad overview of the Commonwealth's finances in a manner similar to a private sector business. The statements include the *Statement of Net Assets*, which present the assets, liabilities and net assets for the government as a whole. Also presented is the *Statement of Activities*, which presents the functional expenses, offsetting revenues and changes in net assets of the Commonwealth. Both of the statements have separate sections for three different categories of the Commonwealth's operations. These activities are *Governmental Activities*, *Business-Type Activities* and *Discretely Presented Component Units*. For FY04, additional information is presented for college and university foundations in accordance with the implementation of Government Accounting Standards Board (GASB) Statement 39.

The government – wide financial statements can be found immediately following this discussion and analysis.

### Fund Financial Statements and Component Unit Financial Statements

*Funds* are groups of related accounts that are used to maintain control over resources that have been segregated for specific activities or objectives. The Commonwealth, like other governments, uses fund

accounting to ensure and demonstrate compliance with finance related legal requirements. Their financial statements focus on individual parts of the Commonwealth government, reporting its operations in more detail than the government – wide statements. All of the funds of the Commonwealth can be divided into three categories. It is important to realize that these fund categories use different bases of accounting and should be interpreted differently. The three categories of funds are *Governmental Funds, Proprietary Funds and Fiduciary Funds*. Further discussion on the funds can be found in the section “Financial Analysis of the Commonwealth’s Funds” and in Note 1 to the financial statements.

Component unit financial statements are presented for entities where the Commonwealth has financial accountability, but are independent of the core Commonwealth operations. They operate similar to private - sector businesses.

### Notes to the Financial Statements, Required Supplementary Information and Other Supplementary Information

The notes provide additional information that is essential to a full understanding of the financial statements as of the date provided in the government – wide and the fund financial statements. The notes to the financial statements can be found immediately following the component units’ financial statements.

The required supplementary information section includes budgetary comparison schedules for the General and Highway Funds, along with a reconciliation comparing the original general appropriation act, all supplemental appropriations and actual budgetary spending. Variance columns are also provided. GASB Statement 41 - *Budgetary Comparison Schedule Perspective Differences*, which was effective for FY03 and forward, requires a further reconciliation schedule of the budgeted revenues and expenses to governmental fund perspective revenues and expenditures.

Other supplementary information is not mandatory, but is included to present combining schedules of minor governmental funds.

## GOVERNMENT – WIDE FINANCIAL ANALYSIS

### Net Assets

#### *Major Long – Term Obligations for Assets of Political Subdivisions (amounts in millions)*

Long - term assistance to authorities .....	\$ 295,591
School construction grants payable.....	3,259,126
Outstanding bonds issued to fund the MBTA .....	579,302
Central Artery / Tunnel Project to be transferred to the Turnpike.....	10,967,508
Central Artery / Tunnel Project to be transferred to Massport.....	<u>365,000</u>
Change in unrestricted net assets due to items unique to the Commonwealth.....	\$ 15,466,527

Net assets may serve over time as a useful indicator of a government’s financial position. The Commonwealth’s combined net assets (governmental and business-type activities) showed a net deficit of nearly \$3.9 billion at the end of 2004. The *unrestricted net assets* are negative by nearly \$11.3 billion. A substantial portion of this deficit is a result of four programs where the Commonwealth decided to fund assets that it does not own. The most significant example of this is to the aforementioned Commonwealth bonding for the Central Artery / Tunnel Project (CA/T) costs. Pursuant to the Metropolitan Highway System legislation from 1997, the CA/T will transfer to the Massachusetts Turnpike Authority and to the Massachusetts Port Authority (Massport) upon completion. Portions that have not been transferred are shown as payables on the Statement of Net Assets. While the assets will be with the Turnpike Authority and Massport, a large portion of the liabilities will remain with the Commonwealth. Starting in FY04, \$10.3 Billion of the related assets to these liabilities have entered into service with the opening of Interstates 93 and 90. The non-right of way portion of these assets is depreciating over forty years until transferred. Depreciation taken on these assets has reduced both

the asset and liability accordingly. Another example of this type of arrangement is school building assistance. The Commonwealth has a liability of \$3.3 billion for its share of the construction costs of schools owned and operated by municipalities. In FY05, legislation will change the funding of school construction from a direct appropriation to a dedicated portion of the sales tax administered by a newly created Massachusetts School Building Authority.

Two other instances where the Commonwealth incurs debt, but has no related assets relate to authorities. The first is for debt that was issued to fund an 18-month lag in operating subsidy costs, otherwise known as “forward funding,” of the Massachusetts Bay Transportation Authority (MBTA) enacted in FY00. The second is the contractual assistance obligations to other authorities to help subsidize their debt service. The majority of these assistance obligations are for the Massachusetts Water Pollution Abatement Trust, the Route 3 North Transportation Improvements Association and the Massachusetts Development Finance Agency. As of June 30, 2004, the outstanding debt remaining related to the “forward funding” costs of the MBTA was approximately \$579 million, while obligations for contractual assistance to other authorities was nearly \$296 million.

Exclusive of assets where the Commonwealth acts as a fiduciary, the Commonwealth’s current cash and investments increased by over \$1.0 billion between July 1, 2003 and June 30, 2004. This is directly due to the increased tax, grant and charges for services revenues offset by increases in the Commonwealth’s core expenses for debt service, Medicaid, other health and human services and in FY04, public safety. Payments for local aid dropped in FY04, as did costs of primary and secondary education. Higher education costs increased. The year was also marked by a continuation of commercial paper borrowing due to the timing of current year receipts and current year major expenses such as the payment of local aid.

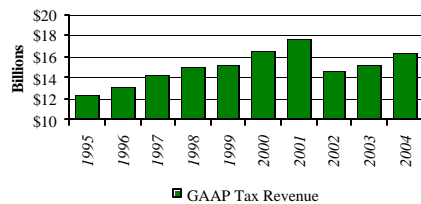
Noncurrent assets increased by nearly \$949 million. A total of nearly \$23.5 billion of the Commonwealth’s net assets reflect the Commonwealth’s investment in traditional capital assets such as land, buildings, infrastructure and equipment, net of accumulated depreciation. GASB Statement 34 requires the addition of the value of investment in the Commonwealth’s infrastructure, including roads, bridges, beaches, dams and other immovable assets to the face of the Commonwealth’s financial statements. As these assets provide services to citizens, they are not available to finance future spending unless they are sold. Although the Commonwealth’s investment in its capital assets is also reported net of related debt, it must be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities.

The bulk of the Commonwealth's net assets lie in its capital assets and long – term liabilities. Current assets and liabilities are amounts that are available in the current period and obligations that will be paid within one year, respectively. The Commonwealth's current assets were over \$9.7 billion, while its current liabilities were nearly \$5.6 billion. Restricted net assets represent resources that are subject to external constraints on resources. The tables below portray the Commonwealth's net assets and the changes to those net assets for the fiscal year. Note that certain amounts were reclassified from FY03 to conform to the FY04 presentation. In addition, due to the implementation of GASB Statement No. 39, net assets of higher education foundations have been included as part of the business – type activities in FY04. FY03 results for these foundations is not available.

***Net Assets as of June 30, 2004 and 2003***  
***(in millions of dollars)***

	<u>Governmental Activities</u>		<u>Business - Type Activities</u>		<u>Total Primary Government</u>	
	<u>June 30, 2004</u>	<u>June 30, 2003</u>	<u>June 30, 2004</u>	<u>June 30, 2003</u>	<u>June 30, 2004</u>	<u>June 30, 2003</u>
Current and other non-capital assets....	\$ 8,976	\$ 7,264	\$ 2,543	\$ 2,179	\$ 11,519	\$ 9,443
Capital assets.....	<u>21,774</u>	<u>20,883</u>	<u>1,691</u>	<u>1,590</u>	<u>23,464</u>	<u>22,473</u>
<b>Total Assets.....</b>	<b><u>30,750</u></b>	<b><u>28,147</u></b>	<b><u>4,234</u></b>	<b><u>3,769</u></b>	<b><u>34,983</u></b>	<b><u>31,916</u></b>
Long term liabilities.....	32,071	30,031	1,205	861	33,276	30,892
Other Liabilities.....	<u>5,020</u>	<u>6,221</u>	<u>547</u>	<u>566</u>	<u>5,567</u>	<u>6,787</u>
<b>Total Liabilities.....</b>	<b><u>37,091</u></b>	<b><u>36,252</u></b>	<b><u>1,752</u></b>	<b><u>1,427</u></b>	<b><u>38,843</u></b>	<b><u>37,679</u></b>
Net assets:						
Invested in capital assets, net of related debt.....	2,033	3,901	1,133	1,073	3,166	4,974
Restricted.....	3,349	1,154	916	946	4,265	2,100
Unrestricted.....	<u>(11,723)</u>	<u>(13,160)</u>	<u>433</u>	<u>322</u>	<u>(11,290)</u>	<u>(12,838)</u>
<b>Total Net Assets (deficits) ....</b>	<b><u>\$ (6,341)</u></b>	<b><u>\$ (8,105)</u></b>	<b><u>\$ 2,481</u></b>	<b><u>\$ 2,341</u></b>	<b><u>\$ (3,860)</u></b>	<b><u>\$ (5,764)</u></b>

**Changes in Net Assets**  
**Revenue from Taxation –**  
**GAAP Basis 1995-2004**



The Commonwealth's net assets increased by over \$1.8 billion. Revenues in general increased, led by tax revenue increases of \$1.2 billion and operating grants and contributions increases of \$1.0 billion. Charges for services also increased dramatically by over \$1.8 billion due to full year phase in of assessment increases from FY03 and a \$541 million increase in unemployment compensation charges. Approximately 50% of the Commonwealth's total revenue came from taxes, while the remainder resulted from programmatic revenues, including charges for services and grants and contributions, the bulk of which is federal aid. Increases also occurred in restricted net assets amounting to \$1.4 billion largely due to an additional crossover refunding of debt and additional amounts set aside for stabilization. This is coupled with decreased spending in the Unemployment Compensation Fund, but slight increases to Higher Education. However, Medicaid spending continued to increase as did other Health and Human Services largely connected to the continual skyrocketing medical costs. Other programmatic expenses remained largely unchanged or dropped due to tighter budget controls.

The Commonwealth's revenues are presented in the table and graphics that follow. Note that certain amounts were reclassified from FY03 to conform to the FY04 presentation. The beginning balance of FY04 business type activities has been restated due to the implementation of GASB Statement No. 39. No prior year data is available for the addition of foundation activities underlying the restatement.

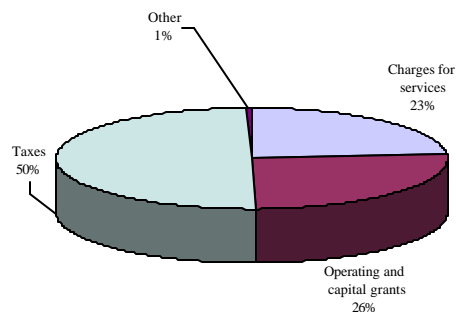
**Changes in Net Assets during the Fiscal Years Ended June 30, 2004 and 2003**  
**(in millions of dollars except percentages)**

	Governmental Activities		Business - Type Activities		Total Primary Government		Total Primary Government		
	June 30, 2004	June 30, 2003	June 30, 2004	June 30, 2003	June 30, 2004	June 30, 2003	June 30, 2004	June 30, 2003	% Change
							Percentage	Percentage	
<b>Revenues</b>									
Program Revenues:									
Charges for services.....	\$ 7,740	\$ 6,652	\$ 2,692	\$ 1,943	\$ 10,432	\$ 8,595	27%	25%	2%
Operating grants and contributions.....	8,017	7,130	1,377	1,250	9,394	8,380	25%	25%	0%
Capital grants and contributions.....	602	508	-	-	602	508	2%	1%	0%
General Revenues:									
Taxes.....	16,407	15,162	-	-	16,407	15,162	43%	45%	-1%
Other.....	1,043	1,180	182	207	1,224	1,387	3%	4%	-1%
<b>Total Revenues.....</b>	<b>33,808</b>	<b>30,632</b>	<b>4,251</b>	<b>3,400</b>	<b>38,059</b>	<b>34,032</b>	<b>100%</b>	<b>100%</b>	<b>0%</b>
<b>Expenses</b>									
Medicaid.....	6,909	6,177	-	-	6,909	6,177	19%	17%	2%
Direct local aid.....	4,877	5,119	-	-	4,877	5,119	13%	14%	-1%
Other health and human services.....	4,829	4,314	-	-	4,829	4,314	13%	12%	1%
Lottery.....	3,607	3,470	-	-	3,607	3,470	10%	10%	0%
Higher education.....	-	-	2,579	2,480	2,579	2,480	7%	7%	0%
Primary and secondary education.....	1,211	1,385	-	-	1,211	1,385	3%	4%	-1%
Unemployment compensation.....	-	-	2,461	2,589	2,461	2,589	7%	7%	0%
Other.....	9,781	10,345	-	-	9,781	10,345	28%	29%	-1%
<b>Total Expenses.....</b>	<b>31,214</b>	<b>30,811</b>	<b>5,040</b>	<b>5,069</b>	<b>36,254</b>	<b>35,880</b>	<b>100%</b>	<b>100%</b>	<b>0%</b>
<b>Excess / (Deficiency)</b>									
<b>before transfers.....</b>	<b>2,594</b>	<b>(179)</b>	<b>(789)</b>	<b>(1,669)</b>	<b>1,805</b>	<b>(1,848)</b>			
Transfers.....	(830)	(950)	830	950	-	-			
Change in Net assets (deficits).....	1,763	(1,129)	41	(719)	1,804	(1,848)			
Net assets - beginning (restated).....	(8,105)	(6,976)	2,441	3,060	(5,664)	(3,916)			
Net assets - ending.....									
<b>Total Net Assets (deficits) .....</b>	<b>\$ (6,341)</b>	<b>\$ (8,105)</b>	<b>\$ 2,482</b>	<b>\$ 2,341</b>	<b>\$ (3,860)</b>	<b>\$ (5,764)</b>			

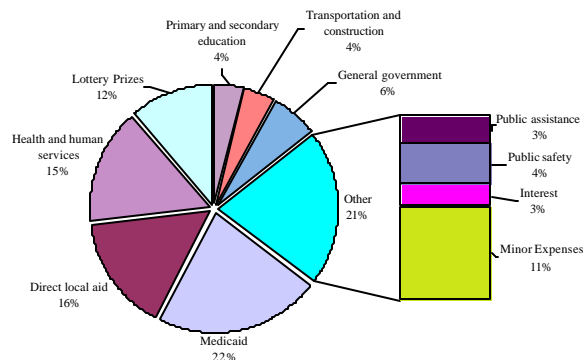
The largest category of tax revenue is income taxes. Of the \$16.4 billion in tax revenue within governmental activities, \$9.2 billion was from income taxation, \$3.8 billion from sales, \$975 million from corporations, \$685 million from motor fuels and nearly \$1.8 billion from other forms of taxation. The largest operating grants are the federal Medicaid subsidies. The largest capital grants are for transportation, including federal grants for the Central Artery / Tunnel project. Finally, Lottery revenues encompass approximately 59% of the Commonwealth's charges for services.

Medicaid represents 22% of all the Commonwealth's governmental expenses. However, it must be noted that over half of the Medicaid expenses are subsidized in the form of federal grants. These subsidies are noted below in the "charges for services" segment. The largest expense that is not subsidized by program revenues is direct local aid to the municipalities of the Commonwealth. According to the Department of Revenue, Division of Local Services, nearly 73% of these funds are earmarked for public education or related activities. Below is a chart that summarizes governmental expenses of the Commonwealth.

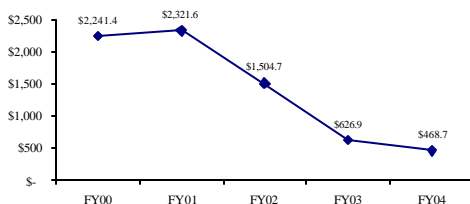
**Revenue – Governmental Activities**  
*Fiscal Year Ending June 30, 2004*



**Major Expenses – Governmental Activities**  
*Fiscal Year Ending June 30, 2004*



**Business – Type Activities**  
**Unemployment Compensation Fund**  
**Net Assets**  
**Fiscal Year Ending June 30, 2004**  
(Amounts in Millions)



Business – type activities are functions that equate to activities of a private enterprise. In the Commonwealth the institutions of higher education are deemed to be business type activities because of their lack of separate taxation. Also, unemployment compensation is considered to be a business – type activity.

The business - type activities increased the Commonwealth's net assets by over \$41 million. This primarily resulted from an \$158 million decrease in the Commonwealth's Unemployment Compensation Fund net assets due to extended benefits for unemployed workers during the year, despite a 58% increase in contributions.. This decline was offset by a \$199 million increase in the net assets of the schools of higher education, largely due to increases in net tuition and fee revenue (by over 22%) and in federal grants and reimbursements (by over 10%).

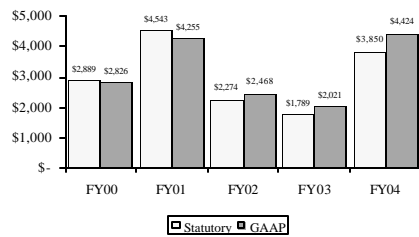


## FINANCIAL ANALYSIS OF THE COMMONWEALTH'S FUNDS

As noted earlier, the Commonwealth uses fund accounting to demonstrate interperiod equity and the extent to which current resources are financing the full cost of services that citizens are receiving.

### Governmental Funds

**Governmental Fund Balance  
Statutory vs. GAAP**  
(Amounts in Millions)



Governmental funds account for the near term inflows, outflows and balances of spendable resources of the Commonwealth's core functions and services. Each major fund is presented in a separate column in the governmental fund balance sheet and in the governmental fund statement of revenues, expenditures and changes in fund balances. The basic governmental funds financial statements can be found immediately following the government-wide financial statements.

The Commonwealth develops its budgets on a statutory basis. A comprehensive process is conducted with all departments to convert the statutory basis reporting to generally accepted accounting principles. System generated reports from the state accounting system and data warehouses are combined with reports from each of the Commonwealth departments to record governmental fund perspective, departmental accruals. There are four major items which account for almost all the difference between the statutory basis reporting and the governmental fund perspective: accruals for the Medicaid program, compensated absences, claims and judgments and tax revenue accruals. From the governmental fund perspective, additional major adjustments are necessary to present the government wide statements, largely for debt and fixed assets activity.

### Governmental Fund Operations - GAAP Basis - Fund Perspective (Amounts in millions)

	FY00	FY01	FY02	FY03	FY04
Beginning fund balances .....	\$2,673.3	\$2,826.1	\$4,255.4	\$2,467.9	\$2,021.0
Restatement due to implementation of GASB 34	-	-	551.2	-	-
Revenues and other financing sources.....	38,174.4	39,256.4	36,476.6	42,798.0	44,371.7
Expenditures and other financing sources.....	38,021.6	37,827.1	38,815.3	43,244.9	41,968.3
Excess / (deficiency).....	152.8	1,429.3	(1,787.5)	(446.9)	2,403.4
Ending fund balances .....	<u>\$2,826.1</u>	<u>\$4,255.4</u>	<u>\$2,467.9</u>	<u>\$2,021.0</u>	<u>\$4,424.4</u>

As of the end of fiscal 2004, the Commonwealth's governmental funds reported combined ending fund balances of over \$4.4 billion, an increase of over \$2.4 billion from the previous year. However, of the \$4.4 billion, the following amounts are reserved or committed:

### Governmental Funds - Reserves of Fund Balances

(Amounts in millions)

	<u>2004</u>	<u>2003</u>	<u>Change</u>	<u>Percentage Change</u>
Continuing appropriations .....	\$ 638.5	\$ 50.7	\$ 587.8	1159%
Commonwealth stabilization .....	1,137.3	641.3	496.0	77%
Retirement of indebtedness .....	761.3	337.3	424.0	126%
Capital projects .....	734.7	936.2	(201.5)	-22%
Central artery Workers Compensation and General liability insurance reserve..	159.0	200.2	(41.2)	-21%
Unreserved	<u>993.5</u>	<u>(144.7)</u>	1,138.2	
<b>Total Fund Balances .....</b>	<b>\$ 4,424.4</b>	<b>\$ 2,021.0</b>	<b>\$ 2,403.4</b>	

The percentage change in unreserved is not meaningful, as the FY03 balance was negative. During FY04 over \$531 million was used from the stabilization fund to balance the budget. These draws were offset by contributions to the stabilization fund in the amount of over \$1.0 billion.

The amounts reserved for capital projects represent projects that are in process, but have been bonded for in advance. As project costs are expended, the reserve will decrease. The bulk of these funds relate to the Central Artery / Tunnel project. The reserve for Central Artery workers' compensation and general liability represents the balance of funds earmarked for claims in an owner controlled insurance program. The reserve will continue to decline as claims arise during the windup of the project. The remaining \$994 million of the governmental fund balance is an unreserved fund balance.

During FY04 the general and highway funds were the primary operating funds of the Commonwealth. At the end of the current fiscal year, the fund balance of the general fund was nearly \$2.5 billion. Of this amount, over \$1.1 billion was apportioned to the Commonwealth's Stabilization Fund. Nearly \$346 million was also reserved for continuing appropriations to liquidate contracts and purchase orders from the prior fiscal year in the general fund. The remaining \$1.0 billion is unreserved.

The fund balance of the general fund increased by nearly \$1.2 billion during FY04.

## **Proprietary Funds**

Proprietary Funds report activities of the Commonwealth that are structured similar to for profit businesses. Proprietary fund financial statements provide the same type of information as the government – wide financial statements, only in greater detail.

As discussed in the business – type activities above, the business type activities decreased the Commonwealth’s net assets by over \$41 million.

## **BUDGETARY HIGHLIGHTS**

Differences between the original budget and final budget expenditures amount to nearly \$672 million, exclusive of transfers. As revenues increased this fiscal year, supplemental budget legislation grew. The supplemental budgets are summarized as follows:

- ◆ An economic stimulus package budgeting more than \$110 million, creating business tax incentives and a sales tax holiday, along with technology, education and tourism grants.
- ◆ Increases in payments for snow plow operators and homeland security by over \$52 million.
- ◆ A final supplemental budget for nearly \$424 million including \$76 million in additional spending across all sectors, \$92 million in one-time capital spending, \$91 million to cure a structural Medicaid deficit, \$75 million for additional local aid and \$131 million for other programs and services including education and public defenders.

The original budget was passed on June 20, 2003, just before the start of FY04. Transfers of revenues and expenditures, largely related to stabilization activity and taxation transfers resulted in nearly \$1.4 billion of additional financial uses, net.

## **CAPITAL ASSET AND DEBT ADMINISTRATION**

### **Capital Assets**

Capital assets of the Commonwealth include land, buildings, improvements, equipment, vehicles and infrastructure. The Commonwealth’s investment in capital assets for its governmental and business-type activities as of June 30, 2004, amounts to \$32.0 billion, net of accumulated depreciation of \$8.5 billion, leaving a net book value of \$23.5 billion. Infrastructure includes assets that are normally immovable and of value only to the Commonwealth, such as roads, bridges, beaches, piers and dams. Of the investment in capital assets noted above though, \$11.6 billion of this amount includes assets that will transfer to the Turnpike Authority and the Massachusetts Port Authority upon completion of the Central Artery / Tunnel project that are in use and depreciating or are right of way. An additional \$1.7 billion has already been transferred to these Authorities and other entities of completed portions of the project.

The total increase in the Commonwealth’s investment in capital assets from 2003 to 2004 was nearly \$991 million, including increases to construction of the CA/T, but net of disposals and changes in accumulated depreciation. An additional \$10.6 billion, net, was transferred from construction in process to fixed assets, over \$10.3 billion of which was related to CA / T assets transferring to use. Additional information on the Commonwealth’s capital assets can be found in the notes to the financial statements.

The following table details the capital asset activity for the Commonwealth. Similar to previous charts, FY04 amounts for business-type activities include amounts for foundations, but FY03 does not.

#### Changes in Capital Assets

(net of depreciation - amounts in thousands)

	Governmental Activities		Business - type Activities		Total	
	2004	2003	2004	2003	2004	2003
Land, including Central Artery .....	\$ 1,127,714	\$ 674,362	\$ 59,361	\$ 58,478	\$ 1,187,075	\$ 732,840
Historical treasures .....	-	-	703	672	703	672
Construction in process .....	1,023,815	729,867	136,233	154,698	1,160,048	884,565
Construction in process - Central Artery / Tunnel Project .....	1,244,463	10,650,559	-	-	1,244,463	10,650,559
Buildings .....	1,982,991	1,888,286	1,128,039	1,000,699	3,111,030	2,888,985
Machinery and equipment .....	120,869	123,415	260,741	269,359	381,610	392,774
Infrastructure, including Central Artery ....	16,273,667	6,816,307	-	-	16,273,667	6,816,307
Library collections .....	-	-	105,590	106,540	105,590	106,540
<b>Total .....</b>	<b>\$ 21,773,519</b>	<b>\$ 20,882,796</b>	<b>\$ 1,690,667</b>	<b>\$ 1,590,446</b>	<b>\$ 23,464,186</b>	<b>\$ 22,473,242</b>

#### Debt Administration

The Commonwealth issues short-term and long-term debt. Debt that is general obligation in nature is backed by the full faith and credit of the Commonwealth and paid from governmental funds. Additionally, short-term notes are issued and redeemed annually.

The Commonwealth issued nearly \$4.9 billion in debt this year. Of this amount, \$1.9 billion to fund ongoing projects and over \$2.9 billion was in the form of general obligation refunding bonds, taking advantage of low interest rates. These refundings generated approximately \$96.4 million in present value debt service savings. Subsequent to year-end, the Commonwealth completed an additional refunding transaction which generated an additional \$23.7 million in present value debt service savings.

Though the majority of bond sales this year were for transportation related expenditures, for governmental purposes, the \$1.9 billion in ongoing projects bond sales also included debt issuances of:

- ◆ \$20.0 million for the affordable housing trust fund capitalization.
- ◆ Over \$79.3 million for information technology improvements.
- ◆ Nearly \$51.5 million for housing preservation and neighborhood loans.
- ◆ \$693.4 million for the permanent financing of the Boston Convention and Exhibition Center.
- ◆ Nearly \$121.5 million for improvements to courthouses.
- ◆ Nearly \$55.8 million for criminal justice purposes.
- ◆ Over \$758 million in bond principal was repaid.

Additional information on the Commonwealth's short and long-term debt obligations can be found in the notes to the financial statements.

Below is a table, which details the Commonwealth's debt activity for the fiscal year. FY04 amounts include foundation debt for business-type activities. FY03 does not.

#### Changes in Long - Term Debt Obligations

(net of related premiums and discounts - amounts in thousands)

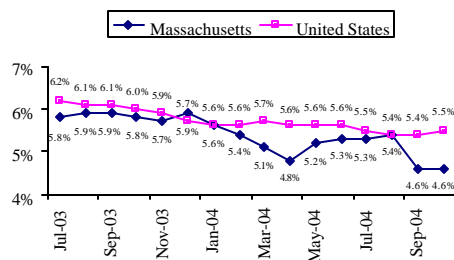
	Governmental Activities		Business - type Activities		Total	
	2004	2003	2004	2003	2004	2003
General obligation bonds .....	\$ 14,142,886	\$ 13,724,121	\$ -	\$ -	\$ 14,142,886	\$ 13,724,121
Special obligation bonds .....	1,331,946	739,061	-	-	1,331,946	739,061
Revenue obligation bonds .....	-	-	1,049,095	673,398	1,049,095	673,398
Grant anticipation notes .....	1,907,340	1,499,325	-	-	1,907,340	1,499,325
<b>Total .....</b>	<b>\$ 17,382,172</b>	<b>\$ 15,962,507</b>	<b>\$ 1,049,095</b>	<b>\$ 673,398</b>	<b>\$ 18,431,267</b>	<b>\$ 16,635,905</b>

## ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES

Massachusetts is starting to recover economically. Our Commonwealth is home to many world-renowned institutions of medicine and higher education, both public and private, keeping the economy relatively stable and an incubator for new ideas and growth. Unemployment has dropped due to this stabilization.

The Commonwealth with an international reputation for medical, cultural, historical and educational institutions remains the economic and educational hub of New England. The Commonwealth's economy remains diversified, but its strongest component is its knowledge – based technology and service industries.

### Monthly Unemployment Rate July 2003 – October 2004



Massachusetts' infrastructure provides strong support for this knowledge-based economy. There are over 120 colleges and universities located in Massachusetts, and the 2000 US Census, updated in March of 2002, estimated that 34.3% of the residents over age 25 have earned bachelor's degrees, compared to an estimate of 26.7% for the United States as a whole. Massachusetts ranks third in the nation in educational attainment by age 25 within only 1.5% of the leader, Colorado.

Inflation has risen though in the past year. The Boston consumer price index rose 2.9% from July 2003 to July 2004. The largest component of this increase was due to fuel and utilities costs rising 6.0% during the period.

As of October 2004, the unemployment rate in the Commonwealth stood at 4.6%. This figure is down from a high of 5.9% several months last year, the highest rate since November of 1994. The Commonwealth is still below the national rate of 5.5%.

## REQUESTS FOR INFORMATION

This financial report is designed to provide a general overview of the Commonwealth's finances for all of the Commonwealth's citizens, taxpayers, customers, investors and creditors. Questions concerning any of the information provided in this report or requests for additional information should be addressed to: Commonwealth of Massachusetts, Office of the State Comptroller, 1 Ashburton Place, 9<sup>th</sup> Floor, Boston, Massachusetts, 02108. You may also download this report at: <http://www.mass.gov/osc/reports/reports.htm>.